

ADMINISTRATIVE PROCEEDING  
FILE NO. 3-2256

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

---

In the Matter of  
INTERMARK INVESTING, INC.  
(811-1041)

---

**FILED**  
APR 30 1970  
SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

Warren E. Blair  
Hearing Examiner

Washington, D.C.  
April 30, 1970

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

<hr/>		:
In the Matter of		:
INTERMARK INVESTING, INC.	INITIAL DECISION	:
(811-1041)		:
<hr/>		:

APPEARANCES: Milton V. Freeman, Werner J. Kronstein,  
and Robert D. Rosenbaum, of Arnold &  
Porter, and E. Miles Harvey and John W.  
Brooks, Jr., of Luce, Forward, Hamilton &  
Scripps, for Intermark Investing, Inc.

Anne P. Jones and A. Barry Witz, for the  
Division of Corporate Regulation.

BEFORE: Warren E. Blair, Hearing Examiner.

Intermark Investing, Inc. ("Intermark"), which is registered as a closed-end investment company under the Investment Company Act of 1940 ("1940 Act"), filed an application for an order under Section 8(f) of the 1940 Act declaring that Intermark has ceased to be an investment company as defined in the 1940 Act. According to the application, Intermark operated as a licensed small business investment company ("SBIC") under the name of Southwestern Capital Corporation until September, 1968. It then assumed its new name, surrendered its SBIC license, and adopted a program designed to change the nature of Intermark's business to that of an operating company. The application further represents that in keeping with its program, Intermark acquired ten operating companies, or groups of operating companies, has negotiations in progress to acquire others, has assembled a management team capable of managing an operating-holding company, and has taken steps to dispose of its portfolio securities in orderly fashion.

After making a preliminary examination of the application, the Division of Corporate Regulation ("Division") raised questions about whether "earnouts"<sup>1/</sup> which were used by Intermark in connection with its acquisitions violated Sections 18 and 23 of the

---

<sup>1/</sup> An "earnout" is a payment by an acquiring corporation of additional consideration for an acquired company in the event that the earnings of the acquired company during the first two or three years after its acquisition are higher than anticipated by the acquiring corporation.

1940 Act, whether Intermark has ceased to be an investment company, and if no longer an investment company, whether an order so declaring should contain appropriate conditions. Pursuant to notice and order for hearing entered on November 24, 1969, a hearing was held on the application and the issues raised by the Division. At the outset of the hearing, an additional issue relating to the accuracy of the proxy material used by Intermark in 1968 was raised by the Division, and the Commission's order was amended to include that issue for consideration in these proceedings.

As part of the post-hearing procedures, successive filings of proposed findings, conclusions, and supporting briefs were specified. Timely filings thereof were made by the applicant and the Division. The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

INTERMARK INVESTING, INC.

Intermark, formerly Southwestern Capital Corporation, was incorporated in California in September, 1960 and became registered under the 1940 Act as a closed-end, non-diversified management investment company in April, 1961. It was licensed by the Small Business Administration ("SBA") on June 8, 1961 as a small business investment company ("SBIC"), and operated as such until September 30, 1968 when it surrendered its SBIC license.

In the fall of 1967, Roberts, Scott & Co. ("RSC") gained control of Intermark by purchasing 52% of its then outstanding shares. Charles R. Scott ("Scott"), RSC's president and owner of nearly 25% of its stock, became a director of Intermark and served in that position until the September 19, 1968 stockholders meeting. Scott did not stand for reelection as a director because a preliminary injunction had been entered on December 8, 1967 by a United States District Court upon consent of RSC and two of its employees enjoining them from further violating certain sections of the Securities Act of 1933 and Securities Exchange Act of 1934 in connection with the offer and sale of shares of North American Research and Development Corporation, a company not otherwise involved in this proceeding.<sup>2/</sup>

In May, 1968 Intermark's board of directors voted to recommend to the stockholders a change in the nature of the company's

---

<sup>2/</sup> SEC v. North American Research and Development Corporation, 67 Civ. 3724 (S.D.N.Y.). Section 9(a) of the 1940 Act, inter alia, makes it unlawful for any person who by reason of any misconduct is enjoined from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security, "to serve or act in the capacity" of officer or director of a registered investment company. The injunctive order being directed against RSC, "its agents, employees, . . . and those persons in active concert or participation with it," there is a question, not here considered, of whether Scott, who was neither named as an individual defendant nor charged with misconduct in the injunctive action, is a person enjoined within the meaning of Section 9(a).

business from that of an investment company to that of an "operating-holding" company. In line with that decision, proxy statements used in connection with the September 19, 1968 stockholders' meeting were mailed on September 7, 1968.

Prior to the September meeting, Intermark began to formulate plans to implement its changeover in operations. Scott recruited Nicholas Wallner, a financial consultant, for the position of president of Intermark, and on June 25, 1968 he stepped into that position. Wallner was charged with the responsibility of improving, modifying, and then executing the tentative plans that Scott had presented to Intermark's board of directors.

Following the September stockholders meeting at which the change in the nature of Intermark's business received approval, Intermark surrendered its SBIC license and Wallner entered into acquisition negotiations with a number of companies. During the period March 24, 1969 to November 30, 1969 Intermark or its wholly-owned subsidiaries acquired all of the outstanding

capital stock or assets of the following companies on the dates indicated:

Metro U. S. Services Inc., 3/24/69	Pomona Bus Lines Charter Service, 4/21/69
Intermark Electronics, Inc. (formerly Western Electronics Component and WEC North, Inc.), 3/26/69	Sea Coast Equipment Co., 5/15/69
San Diego Plating, Inc. and Wheeler Enterprises, Inc., 3/26/69	Associated Truck Rentals, 5/26/69
Arts & Crafts Press, 3/28/69	Morrissey Equipment Corp., 6/2/69
Advanced Development Corp. 3/31/69	Nurseryland Investment Co., 7/22/69
Topaz, Inc., 3/31/69	Golden West Transit Lines, 8/27/69
Wilpac Manufacturing Co., 3/31/69	Travis Plating Co., Inc., 9/9/69
Rent-Mor, Inc., 4/7/69	Modern Lift Truck & Equip- ment Co., 9/18/69
Community Enterprises, Inc., 4/10/69	Robert F. Wright Co., 9/18/69
Claus Charter Buses, 4/21/69	Kaysons International, Ltd., 11/6/69

Intermark presently is actively engaged in operating through its wholly-owned subsidiaries a number of industrial and commercial businesses. On an unconsolidated basis as of July 1, 1969 investment securities constituted 29.6 per cent of Intermark's total assets exclusive of cash items and on the same basis as of November 30, 1969, investment securities represented only 24.6 per cent of those assets.

SECTION 18 OF THE INVESTMENT  
COMPANY ACT OF 1940

Ten of Intermark's acquisitions were negotiated on the basis of so-called "earnouts," contracts calling for the exchange

of all outstanding stock of each company being acquired for a fixed number of shares of Intermark stock to be issued at the closing of the acquisition, together with a provision that Intermark issue additional shares in installments over a three-year period, the amount of stock, if any, to be issued to depend upon the earnings of the acquired company during the twelve months prior to the installment. The Division argues, and with merit, that the earnouts offered by Intermark are securities within the meaning of the 1940 Act.

In the comprehensive securities regulatory scheme adopted by Congress commencing with the Securities Act of 1933, the 1940 Act represents the final enactment, and it was deemed necessary not only because "investment companies are affected with a national public interest . . ." <sup>3/</sup> but also because it was determined from an extensive study of Investment Trusts and Investment Companies conducted by the Commission that "the national public interest and the interest of investors are adversely affected. . . ." <sup>4/</sup> by certain conduct and activities of or involving investment companies. In particular, Section 1(b) of the

---

3/ Section 1(a) of the 1940 Act.

4/ Section 1(b) of the 1940 Act.



1940 Act recognized the adverse effect upon the public interest and investors,

. . . .

(3) when investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders of their outstanding securities;

. . . .

(7) when investment companies by . . . the issuance of excessive amounts of senior securities increase unduly the speculative character of their junior securities; . . . .

Being remedial legislation, the 1940 Act must under recognized principles of statutory interpretation be given a liberal construction, that which will best conform with the general purpose of the legislation.<sup>5/</sup> In keeping therewith, it must be concluded that an earnout is a hybrid security encompassed by one or more of the classes enumerated under Section 2(a)(35) of the 1940 Act which includes in the definition of "security" a "certificate of interest or participation in any profit-sharing agreement, . . . investment contract, or . . . ."

The earnout here, in its essentials, is found to be primarily a participation or interest in a profit-sharing agreement

---

<sup>5/</sup> SEC v. Joiner Corp., 320 U.S. 344, 350-51 (1943).

issued by Intermark which is evidenced by a certificate in the form of the acquisition agreement entered into between Intermark and the sellers of the acquired company's stock or assets. The terms of the agreement, while avoiding a direct reference to profit-sharing, make it clear nonetheless that the parties are composing their differences regarding the value of the acquired company by the sellers' acceptance of the value that Intermark has determined in exchange for a contingent share of the acquired company's future earnings to be paid in the form of Intermark stock.

The earnout also may be viewed as an investment contract issued by Intermark. As defined by the Supreme Court in SEC v. <sup>6/</sup>Howey Co.,

[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed by the enterprise.

The earnout agreement meets the Court's definition in every material way, and there appears to be no reason why the same definition of investment contract should not be carried over to the 1940 Act for the purposes of effectuating its purposes. A

---

<sup>6/</sup> 328 U.S. 293, 298-99 (1946).

valuable consideration has flowed to Intermark from the sellers which is tantamount to their investing money; that investment is in a common enterprise represented by the acquired company, and for a profit the sellers must depend upon others to operate the acquired company. It is therefore concluded that the earn-out is an investment contract within the meaning of the 1940 Act.

The Division's argument that the earnout may also be considered a "security" in that it represents a "warrant or right to subscribe to or purchase"<sup>7/</sup> additional stock of Intermark is not persuasive. By the terms of the Intermark agreement they are entitled to a payment of Intermark stock under certain specified conditions, and no further conscious decision or act is required of them before receipt of that stock upon the fulfillment of the triggering conditions. Accordingly, the earnout represents a more substantial right than the mere opportunity to purchase additional Intermark stock and is, therefore, not deemed to be a warrant or right to subscribe to stock, but a profit-sharing agreement or investment contract.<sup>8/</sup>

Having determined that the earnout represents either a certificate of interest or participation in a profit-sharing

---

<sup>7/</sup> Section 2(a)(35) of the 1940 Act.

<sup>8/</sup> Cf. Lawrence v. SEC, 398 F. 2d 276 (1st Cir. 1968).

agreement, or an investment contract issued by Intermark, and it appearing that the earnout's major purpose is to provide a vehicle whereby sellers might receive a further share in those Intermark's profits attributable to the acquired company, it is concluded that the earnout also represents an issue by Intermark of a class of stock other than common stock. In addition, since Section 18(g) of the 1940 Act defines "senior security" as ". . . any stock of a class having priority over any other class as to distribution of assets," and since each earnout has a preferential claim under specified circumstances different from and over all other earnouts and Intermark common stock with respect to a distributive share of Intermark assets, each of the earnouts must be regarded as a "senior security which is a stock" within the meaning of Section 18(c) of the 1940 Act.

Besides common stock, the capital structure of Intermark prior to the issuance of earnouts included authorized but unissued preferred stock. With the issuance of each of the various earnouts, the capital structure became greatly complicated, and as of November 30, 1969, not only common stock, but ten earnouts with each one itself a "senior security which is a stock," were outstanding tiers in the Intermark structure.

Under Section 18(c) of the 1940 Act a registered closed-end investment company is prohibited from issuing or selling

"any senior security which is a stock if immediately thereafter such company will have outstanding more than one class of senior security which is a stock, . . ." It is therefore concluded that by issuance of earnouts in question, Intermark engaged in unlawful acts in violation of Section 18(c), and thereby rendered the agreements voidable under the provisions of Section 47(b) of the 1940 Act.<sup>9/</sup>

Intermark's attempt to analogize earnouts with a technique of "placing a portion of the shares issued by the acquiring company in escrow to be returned to the acquiring company if the earnings of the acquired company do not reach or maintain a specified level," is to no avail. Such a technique might well be construed as a security if it were used under circumstances showing that the substance of the parties' agreement was to permit the sellers to share in the acquired company's profits. Here it is found that Intermark established the value of the acquired company and was unwilling to pay more for the acquired company at the time of acquisition than the fixed amount of Intermark stock. The additional earnout agreement represented a willingness to share with sellers in the acquired company's profits

---

9/ Section 47(b) in pertinent part provides:

Every contract made in violation of any provision of this title . . . shall be void (1) as regards the rights of any person who, in violation of any such provision . . . shall have made . . . any such contract, . . . .

in order to obtain their consent to sell at a value lower than the amount they believed proper. The further suggestion that the earnouts are without value other than as expectation of receiving additional Intermark stock is beside the point, since the ultimate question is not the form in which sellers would receive their shares in the profit but whether they are entitled to share in those profits.

Intermark's further argument that if the earnouts are securities, then they are the equivalent of common stock must also be rejected. Its reliance upon Carlberg v. United States<sup>10/</sup> is misplaced. The sole issue in the Carlberg case, as pointed out by the Court, was "whether the 'Certificates of Contingent Interest' . . . received by shareholders . . . upon the merger, qualify as 'stock,' within the meaning of § 354(a), or, instead, as 'other property,' within the meaning of § 356(a)(1) [of the Internal Revenue Code of 1954]."<sup>11/</sup> As an interpretation of the Internal Revenue Code, the decision is not controlling precedent in construing the remedial provisions of the 1940 Act. Over and beyond that, it is apparent that the Court was not attempting to decide whether the Certificate of Contingent Interest was common stock or a senior class of stock when it concluded that "[w]hat

---

<sup>10/</sup> 281 F. 2d 507 (8th Cir. 1960).

<sup>11/</sup> Id. at 509.

the holder possessed was either stock or it was nothing."<sup>12/</sup>  
Its sole interest was in determining whether the Certificate of  
Contingent Interest fell into the category of "stock" or "other  
property" under the Internal Revenue Code.<sup>13/</sup> However, it may  
be noted in passing that the Carlberg case lends support to the  
earlier finding herein that the earnout is not only a "security"  
but a "stock" within the meaning of the 1940 Act.

Intermark's additional view that an earnout cannot be  
considered a senior security for the purpose of Section 18 is  
rejected. The fact that the agreements do not give the sellers  
the right to vote or receive dividends does not preclude a find-  
ing that under the 1940 Act earnouts are classes of stock. The  
essential quality in the earnouts which suffices for that find-  
ing is the participation or sharing in a part of Intermark's  
equity position. Further, each of the agreements in essence  
grants a priority over common stock and over every other earnout  
to the extent of the interest in the profits of a particular  
acquired company. In the event of liquidation of Intermark, it

---

<sup>12/</sup> Id. at 519.

<sup>13/</sup> Revenue Rulings cited by applicant which indicate that  
under the Internal Revenue Code a contingent right to addi-  
tional shares issued in connection with a corporate reorgan-  
ization will be treated as common stock are inapposite.

would appear that each of the sellers would be entitled to and receive a preference or be granted a prior claim in the distribution of assets in an amount dependent upon value of their respective shares computed on the basis of the agreements. If it happened that an acquired company's profits were undistributed at the time of Intermark's liquidation, it would further appear that the sellers of that company would be entitled to a direct claim against the assets of that subsidiary.

SECTION 23 OF THE INVESTMENT COMPANY  
ACT OF 1940

The Division's position that the earnouts also involve a violation of Section 23(a) of the 1940 Act <sup>14/</sup> is untenable. Contrary to the Division's assertion, the record does not establish that a substantial portion of the earnouts were issued to compensate management of the acquired companies for their future services in managing the companies as Intermark subsidiaries. Undoubtedly, it was in their interest to remain, and Intermark made it attractive for them to do so, but it appears that the question of future services was merely incidental, if considered at all, in connection with the determination of the earnout

---

<sup>14/</sup> In pertinent part Section 23(a) of the 1940 Act provides "[n]o registered closed-end investment company shall issue any of its securities (1) for services, . . ."



agreements. In that connection the Division is mistaken in its reliance upon the fact that Intermark in effect suggested to shareholders of Topaz who were not to be employed by Intermark following the acquisition of Topaz that they should contribute one-half of their contingent shares to provide management incentive. A reasonable inference to be drawn from Intermark's suggestion is that it was looking to the former Topaz shareholders to assure continuity of management and was not itself intending to issue its stock for services to be rendered.

FALSE AND MISLEADING PROXY STATEMENT

The proxy solicitation which preceded Intermark's September 19, 1968 stockholders meeting made use of a materially false and misleading proxy statement that failed to disclose material facts concerning Intermark's proposed change in operations and the manner in which Intermark's future operations would be conducted. In particular, the proxy statement did not set forth all of the considerations that entered into the surrender of Intermark's SBIC license, and with respect to future operations omitted disclosure of the proposed use of earnouts in acquisition agreements, the independence of operations by acquired subsidiaries, and the reasons for such autonomous operation of subsidiaries.

According to the record, which now includes William Jenkins' affidavit of April 9, 1970 and exhibits thereto submitted by applicant's counsel, prior approval of the SBA for the transfer of control of Intermark to RSC was not obtained as required by SBA regulations.<sup>15/</sup> Application for approval of RSC's accession to control was filed on October 3, 1967, but never granted, the SBA advising Intermark's counsel around April 15, 1968 that it would not approve such transfer but would favorably consider a voluntary surrender of Intermark's SBIC license. On April 23, 1968 Intermark's then counsel and Scott were advised during a personal meeting with SBA representatives in Washington, D.C. that the approval was withheld because of "the failure of Roberts Scott to obtain prior approval of SBA for the transfer of control and the use by Roberts Scott of subordinated capital in making the acquisition."<sup>16/</sup> The SBA representatives also offered to undertake a reconsideration of the question of approval of the transfer of control, but were requested not to do so until after Intermark's directors had a chance to meet. When Intermark's directors met on April 30, 1968, they discussed four courses of action, namely, (1) to seek through court action to have RSC's control recognized, (2) to surrender the SBIC license and convert Intermark to an operating-holding company, (3) to merge with some other SBIC, or (4) to have RSC dispose of its interest. Tentatively, the decision was made to

---

<sup>15/</sup> 13 C.F.R. 107.701.

<sup>16/</sup> Affidavit of William Jenkins, attachment to Applicant's Reply Brief, dated April 13, 1970.

follow the second course, and that view was adopted on May 13, 1968 when the board of directors voted to recommend to stockholders that Intermark's business be changed from that of an investment company to that of an operating-holding company.

The proxy statement used by Intermark in connection with the September 19, 1968 meeting wholly failed to disclose the difficulties attached to a continuation of the business as an SBIC or the fact that such difficulties were traceable to the acquisition of control by RSC. Instead, Intermark contented itself with a recitation of the advantages that its board of directors believed would flow from a surrender of the SBIC license, and statements to the effect that Intermark had applied for authority to surrender its SBIC license and that SBA had approved the surrender subject to certain conditions, including a withdrawal of its application for approval by SBA of transfer of control to RSC and a favorable vote on the surrender of the license.

An obvious conflict of interest on the part of the directors was involved in their consideration in April and May, 1968 of the direction of Intermark's future, and the failure to reveal that conflict by appropriate disclosure rendered the proxy statement materially misleading. <sup>17/</sup> Under the circumstances,

---

17/ Cf. Mills v. Electric Auto-Lite Co., 90 S. Ct. 616 (1970).

fairness to Intermark shareholders required that the proxy statement should have included a full disclosure of the conflict of interest involved in the directors' recommendations, the refusal by the SBA to approve the transfer of control to RSC, the reasons for that refusal, available alternatives to the recommended change in nature of Intermark's operations, and the manner and extent to which RSC's interest would have been affected by such alternatives.

In addition, the proxy statement was misleading in that under the "Proposed Change in Nature of Operations," a statement is made that "[n]o representation can be made as to the terms upon which the increase in controlled investments and operating assets will be effected. . . ." In fact, the tentative plan of Scott which Wallner had the responsibility of implementing contemplated acquisition of 100% ownership of subsidiaries, the use of earnouts, and autonomous operations within acquired companies. These plans are well within the reasonable implication of the statement in question and being material to an informed judgment by the stockholder, should have been disclosed.

Inasmuch as the failures to disclose the noted conflict of interest and the tentative plan regarding acquisitions render the statement false and misleading, it is concluded that the proxy solicitation of September, 1968 was in contravention of Section 20(a) of the 1940 Act and Section 14(a) of the Securities Exchange

Act of 1934 and of the rules under those Acts.

It is no answer to the use of a misleading proxy solicitation that Intermark consulted with the Division staff prior to the use of the proxy statement and was not told to reveal the directors' conflict of interest and further details of Intermark's plans regarding intended acquisitions. Whether Intermark acquainted the staff with all of the facts surrounding these matters or not, and the record even with the Jenkins affidavit included does not establish that the company did so, the burden of compliance with the 1940 Act and the proxy section and rules of the Securities Exchange Act of 1934 was upon Intermark. The company can neither shift its burden nor excuse its failure to comply with statutory requirements by asserted reliance upon the Commission's staff for guidance.

Intermark is also mistaken in the contention that it had no notice of the Division's intention to raise in this proceeding the issue of insufficient disclosure regarding SBA's refusal to approve the transfer of control. At the hearing herein Division counsel stated on the record that one of the areas of inquiry to be developed while Scott was on the witness stand was "whether or not the intended direction that Intermark was going to take is correctly stated in the proxy statement." The Division's statement is clearly sufficient notice that a question of the adequacy of the disclosure as to all aspects of the circumstances surrounding the

"intended direction" of Intermark was being raised. But regardless of the question of the sufficiency of notice, Intermark's complaint basically is that it was deprived of the opportunity to introduce evidence refuting the Division's allegations on this issue. However, no application to reopen the hearing pursuant to Rule 11(d) of the Rules of Practice has been filed by applicant, and it is therefore assumed that the Jenkins affidavit which was attached to applicant's reply brief sets forth the additional evidence applicant desired in the record. If so, acceptance of the Jenkins affidavit as part of the evidence in the record cures any prejudice that may have been caused by applicant's failure to fully understand the issues being raised by the Division.<sup>18/</sup>

Entirely without merit is applicant's contention that neither the conflict of interest present in connection with the board's recommendation nor the SBA's refusal to approve the transfer of control to RSC was material. Where, as here, a complete change in direction and nature of business of an investment company is presented for consideration, the most strict standards should be imposed and observed to assure complete disclosure to a

---

<sup>18/</sup> IT IS ORDERED that the affidavit of William N. Jenkins subscribed and sworn to on April 9, 1970 and exhibits A through E attached thereto, be, and hereby are, admitted in evidence in this proceeding.

stockholder of the various factors material in reaching voting decisions, and what action, if any, he should take either prior to or after his vote is counted. For all that would appear from the proxy solicitation, the unanimous vote of the board was reached with each of the six directors voting with an eye single to the interests of Intermark and its shareholders. It is idle to speculate how a shareholder might have voted if he had been aware that the SBA would not approve the transfer of control to RSC, and that the nominee of RSC was recommending a change in operations knowing that continuation of Intermark as an SBIC was prejudicial to RSC's interest. Whether the conflict of interest taints one director's vote or all six of the votes cast by Intermark's directors, the stockholder was entitled to know the nature of that conflict and the extent of it.

Applicant's position that the proxy materials were not defective with respect to Scott's relationship with Intermark is in accord with the record. Contrary to the Division's contention, Scott did not continue "to serve or act in the capacity of director" after the September 19, 1968 stockholders meeting. That he remained concerned with the activities of Intermark, was consulted frequently by Wallner, attended the meetings of Intermark's board and executive committee, and influenced generally the course of Intermark's business, are all indicia of Scott's acting as a

director. Countering that, however, is the consideration that Scott, as applicant points out, was president of RSC, the controlling stockholder, with a legitimate interest in attending the meetings and making his views known to the board, executive committee, and to Intermark's president. Weighing all of the evidence bearing on the question and the reasonable inferences that may be properly drawn therefrom, it is found that the Division failed to establish that Scott acted or served in the capacity of a director of Intermark after September 19, 1968.

#### DENIAL OF APPLICATION

While it is clear that Intermark has violated Section 18(c) and Section 20(a) of the 1940 Act and Section 14(a) of the Securities Exchange Act of 1934 and the proxy rules under those Acts, the record has little beyond those violations to support the Division's proposal that Intermark should offer to rescind all acquisitions involving the use of earnouts. It may well be that a rescission offer could be extremely damaging to the interest of the very persons the 1940 Act was designed to protect.

On the other hand, Intermark's assertion that the noted violations are irrelevant is also unacceptable. As the Division has stated, the earnouts have introduced a complicating factor into Intermark's present financial picture by reason of the earnouts having been issued in violation of Section 18 and being



therefore voidable under Section 47(b) of the 1940 Act. Until it is known whether those entitled to void the transactions in question intend to take that action, thereby materially altering Intermark's asset position, an order declaring that Intermark has ceased to be an investment company within the meaning of the 1940 Act appears inappropriate.

The case of Southwestern Development Corporation,<sup>19/</sup> relied upon by applicant, does not require a contrary conclusion. Whether to follow the procedure used in Southwestern Development Corporation of permitting deregistration under certain conditions, or to deny an application filed pursuant to Section 8(f) is within the sound discretion of the Commission.<sup>20/</sup> Here, the continued use of the earnouts in the face of the questions raised by the Division staff and the use of a misleading proxy solicitation compel the conclusion that the public interest and the interests of Intermark's shareholders would be best served for the present by continuing to extend the protections afforded by the 1940 Act to them.

But were applicant correct in its contention that violations of Section 18(c) were irrelevant to the issues herein, the result would be the same because of the misleading proxy solicitation

---

<sup>19/</sup> 24 S.E.C. 686 (1946).

<sup>20/</sup> See The Equity Corporation, Investment Company Act Release No. 6000 (March 5, 1970).

which sets at naught the vote of the stockholders for purposes of Section 13(a)(4) of the 1940 Act.<sup>21/</sup> Compliance with Section 13(a)(4) cannot mean less than a vote cast after all of those entitled to vote are fully and accurately informed of the material facts involved. Nor can the fact that RSC might not have been misled by the proxy materials be accepted as a reason to excuse the use of material misleading to minority shareholders. To hold otherwise would be to make a mockery of the protective provisions of Section 13(a)(4) as well as Section 20 of the 1940 Act. Minority interests would then be left entirely at the mercy of the majority, a result here that would be particularly out of keeping with the purposes of the 1940 Act considering that the conflict of interest involves RSC, the majority stockholder.<sup>22/</sup>

---

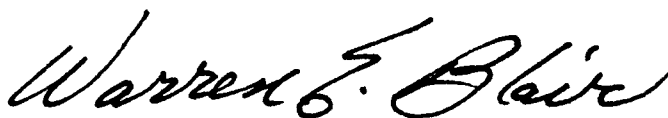
<sup>21/</sup> Section 13(a)(4) of the 1940 Act prohibits a registered investment company from changing the nature of its business so as to cease to be an investment company unless authorized to do so by the vote of a majority of its outstanding voting securities.

<sup>22/</sup> All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.

Accordingly, IT IS ORDERED that the application of Intermark Investing, Inc. for an order declaring that it has ceased to be an investment company be, and it hereby is denied.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Rules of Practice,

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.



Warren E. Blair  
Warren E. Blair  
Hearing Examiner

Washington, D. C.  
April 30, 1970